

Message Text

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ORIGIN TRSE-00

INFO OCT-01 ARA-10 ISO-00 L-02 AID-05 CIAE-00 COME-00

EB-07 FRB-01 INR-07 NSAE-00 XMB-04 OPIC-06 SP-02

CIEP-02 LAB-04 SIL-01 OMB-01 H-02 /055 R

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TREAS/OASIA:TVILLAMIL

ARA/MEX:GFALK

L/T:WM MCQUADE (SUBS)

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R 251504Z FEB 75

FM SECSTATE WASHDC

TO AMEMBASSY MEXICO

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E.O. 11652: N/A

TAGS: EFIN

SUBJECT: INQUIRY ON PROPOSED CHANGE IN FOREIGN TAX CREDIT
COMPUTATION

FOR PASCOE

APPRECIATE MEMORANDUM ON YOUR COURTESY CALL TO CARLOS TELLO.
TELLO'S REFERENCE TO US RESCINDING CREDIT ON INCOME FROM
CERTAIN TYPES OF FOREIGN INVESTMENTS PROBABLY REFERS TO A
PROVISION OF H.R. Z17488 A BILL APPROVED BY THE WAYS AND MEANS
COMMITTEE IN NOVEMBER 1974 BUT NOT ENACTED BY THE HOUSE BEFORE
CONGRESS ADJOURNED. IT HAS NOT YET BEEN INTRODUCED IN THE NEW
CONGRESS.

THERE WERE MANY PROVISIONS CONCERNING FOREIGN INCOME IN
THAT BILL INCLUDING THE REPEAL OF US WITHHOLDING ON INTEREST
PAID TO NONRESIDENT PORTFOLIO INVESTORS, ELIMINATION OF THE
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REDUCED RATE (34 PERCENT) ON WESTERN HEMISPHERE TRADE CORPORATIONS,

AND A LIMITATION ON THE USE OF EXCESS CREDITS BY OIL COMPANIES. ONE OF THE PROVISIONS WOULD HAVE REPEALED THE SPECIAL FOREIGN TAX CREDIT COMPUTATION ON DIVIDENDS FROM SUBSIDIARY CORPORATIONS IN DEVELOPING COUNTRIES. NOW, WHEN A US CORPORATION RECEIVES A DIVIDEND FROM A FOREIGN SUBSIDIARY (10 PERCENT OR MORE OWNERSHIP) IT MAY CLAIM A FOREIGN TAX CREDIT FOR A PORTION OF THE UNDERLYING PROFITS TAX ON THE SUBSIDIARY. WHEN THE DIVIDEND IS FROM A DEVELOPED COUNTRY CORPORATION A PRO-RATA SHARE OF THE UNDERLYING TAX IS ADDED TO THE DIVIDEND AND THEN ALLOWED AS A CREDIT. BUT WHEN THE DIVIDEND IS FROM A DEVELOPING COUNTRY SUBSIDIARY THAT PORTION OF UNDERLYING TAX IS NOT ADDED TO THE DIVIDEND IN COMPUTING TAXABLE INCOME. THE RESULT IS A LOWER US TAX ON DIVIDENDS FROM SUBSIDIARIES IN DEVELOPING COUNTRIES WHENEVER THE US CORPORATE TAX IS HIGHER THAN THE FOREIGN TAX. FOR EXAMPLE, ASSUME DEVELOPED COUNTRY A AND DEVELOPING COUNTRY B BOTH HAVE A 40 PERCENT CORPORATE TAX AND THAT A WHOLLY OWNED US SUBSIDIARY DISTRIBUTES ALL AFTER-TAX PROFITS TO THE US PARENT CORPORATION. THE US TAX IS AS FOLLOWS:

	COUNTRY A (DEVELOPED)	COUNTRY B (DEVELOPING)
1. CORPORATE PROFIT	100	100
2. PROFITS TAX	40	40
3. AFTER TAX PROFIT	60	60
4. DIVIDEND TO US CORPORATION	60	60
5. TAXABLE INCOME IN US	100	100
6. US TAX (48 PERCENT)	48	28.8
7. FOREIGN TAX CREDIT (40 PERCENT LINE 5)	40	24
8. NET US TAX	8	4.8
9. AFTER TAX DIVIDEND	52	55.2
10. EFFECTIVE TAX RATE (LINE 1 - LINE 9)	48	44.8

THE WAYS AND MEANS PROPOSAL WOULD HAVE MADE THE COUNTRY B COMPUTATION THE SAME AS FOR COUNTRY A. KISSINGER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FOREIGN INVESTMENT, DATA, DIPLOMATIC DISCUSSIONS, TAX RELIEF
Control Number: n/a
Copy: SINGLE
Draft Date: 25 FEB 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975STATE041883
Document Source: CORE
Document Unique ID: 00
Drafter: TREASURY.CMNSFUEKDL APPROVED BY:. EB/MUFD/MINACM ROBERT J
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750067-0139
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750214/aaaaamme.tel
Line Count: 98
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN TRSE
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 2
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: ElyME
Review Comment: n/a
Review Content Flags:
Review Date: 16 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <16 MAY 2003 by SilvaL0>; APPROVED <21 JAN 2004 by ElyME>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: INQUIRY ON PROPOSED CHANGE IN FOREIGN TAX CREDIT COMPUTATION
TAGS: EINV, EFIN, MX, (TELLO, CARLOS)
To: MEXICO
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006